

UNITED STATES OF AMERICA
IN SENATE
COMMITTEE ON COMMERCE
AND INTERSTATE COMMERCE
HEARINGS
ON THE
PROPOSED CASE OF THE PUBLIC SERVICE
COMMISSION, 1957

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner.

ENERGY EXPLORATION MANAGEMENT COMPANY, et al.,
Respondents.

PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK, et al.,
Petitioners.

ENERGY EXPLORATION MANAGEMENT COMPANY, et al.,
Respondents.

OFFICE OF COMMISSIONER OF THE UNITED STATES
COURT OF APPEALS FOR THE TENTH CIRCUIT

STATEMENT OF THE CHIEF TRANSMISSION CORPORATION'S
IN SUPPORT OF PETITIONERS

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1987

Nos. 87-363 and 87-364

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

MARTIN EXPLORATION MANAGEMENT COMPANY, *et al.*,
Respondents.

PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK, *et al.*,
Petitioners,

v.

MARTIN EXPLORATION MANAGEMENT COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit

RESPONDENT CNG TRANSMISSION CORPORATION'S
BRIEF IN SUPPORT OF PETITIONERS

STATEMENT OF THE CASE

Respondent CNG Transmission Corporation, formerly Consolidated Gas Transmission Corporation ("CNG Transmission"), is in general agreement with and adopts

the statements and arguments set forth in the briefs of Petitioners Federal Energy Regulatory Commission ("FERC"), and Public Service Commission of the State of New York, *et al.* ("PSC").¹

This case arises under the Natural Gas Policy Act of 1978 ("NGPA").² Title I, Subtitle B of the NGPA creates a scheme of phased price deregulation for most categories of natural gas. *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 336 n.14 (1983). The NGPA generally establishes maximum lawful prices for first sales of natural gas in a number of gas categories. The categories are defined by Subtitle A of Title I and are not mutually exclusive—i.e., certain natural gas can qualify simultaneously under more than one provision. There is also overlap between categories that remain subject to price ceilings ("price regulated gas") and categories that are free from any maximum lawful price ("price deregulated gas").

The FERC initiated a rulemaking proceeding in 1984 to implement the statutory timetable for price deregulation of major categories of new gas. (App. 34a-52a). The FERC construed the NGPA to require that natural gas that is qualified for both price-regulated and price-deregulated status under the NGPA ("dually-qualified gas") be treated as price deregulated. (App. 73a-82a). On appeal of this rulemaking the United States Court of Appeals for the Tenth Circuit rejected the FERC's construction. The court held instead that producers of natural gas could choose whatever statutory category afforded them the highest price under their contracts and market conditions. (App. 1a-24a).

¹ Pursuant to U.S. Sup. Ct. Rule 28, CNG Transmission includes as an Addendum hereto a listing naming all parent companies, subsidiaries and affiliates of Respondent CNG Transmission.

² 15 U.S.C. §§ 3311(b)(5), 3317(c)(5), 3331, 3332 (1982).

Although the court of appeals acknowledged that as a result of its decision considerable gas will be sold at higher regulated prices when contract prices geared to market conditions are at a lower level, it concluded nonetheless that this result was a matter for legislative rather than judicial overview. (App. 23a-24a). The court of appeals denied rehearing and the suggestion for rehearing *en banc*. (App. 29a-31a).

SUMMARY OF ARGUMENT

The court of appeals' conclusion that producers may shift between regulated and deregulated categories directly contravenes Congress' long-term goals. In contrast, the FERC's orders mandating the price deregulation of dually-qualified natural gas are fully consistent with congressional objectives in enacting the NGPA. Congress sought to correct the serious market distortions created by regulation of natural gas prices under the Natural Gas Act ("NGA"). The NGPA, therefore, included a plan of phased price deregulation that would gradually increase the role of market forces in determining natural gas prices. Under the interpretation of the court of appeals, real decontrol of much natural gas would never occur, and prices would be supported at artificially high levels.

The decision of the court of appeals, if permitted to stand, will impose enormous additional costs on purchases of natural gas and will result in substantial prejudice to natural gas pipelines and their customers. CNG Transmission, a natural gas pipeline serving 3,000,000 customers in New England and the Mid-Atlantic states, has estimated that as a result of this decision its gas purchase costs will increase substantially. This increase will occur at a time of surplus natural gas deliverability, a result directly contrary to the establishment of prices by market forces rather than government regulation. The decision of the court of appeals should therefore be reversed.

ARGUMENT

I. THE COURT OF APPEALS' DECISION IS INCONSISTENT WITH THE CONGRESSIONAL INTENT UNDERLYING THE NGPA

The court of appeals' conclusion that producers have the right to choose between regulated and deregulated pricing status directly conflicts with Congress' objectives in adopting the NGPA. In the NGPA, Congress sought to correct the market distortions that had accompanied the regulation of natural gas prices under the NGA. *Mid-Louisiana*, 463 U.S. at 330-31. Congress believed that the NGA's price controls had created an imbalance in supply and demand by holding regulated prices below market levels and by preventing the free market from making long-term adjustments. *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 420 (1986). Through the NGPA, Congress attempted to give market forces a more significant role in determining the price and, consequently, the supply and demand of natural gas. *Id.* at 420-21. This change in regulatory perspective reflected Congress' belief that the free market would provide consumers with the most dependable and the most reasonably priced supply of natural gas. To this end, the NGPA provided both for interim incentive prices and for phased price deregulation. *Id.*

In light of the broad policies that Congress sought to implement by passage of the NGPA, the court of appeals' decision, which turns on its interpretation of NGPA section 101(b)(5), defies logic. NGPA section 101(b)(5) provides:

If any natural gas qualifies under more than one provision of this subchapter providing for any maximum lawful price or any exemption from such price

with respect to any first sale of such natural gas, the provision which *could* result in the highest price shall be applicable.³

In its rulemaking, the FERC held that section 101(b)(5) supports its construction of the NGPA: gas that is qualified for both price-regulated and price-deregulated status would be treated as deregulated. According to the FERC, a deregulated price "always *could* result in a *higher* price than a regulated price . . ." (App. 79a) (emphasis in original). The court of appeals rejected this straight-forward analysis on the ground that the price of *regulated* gas "could" also be higher than the price of *deregulated* gas. (App. 15a-16a). The court of appeals' proposition contravenes any meaningful understanding of the statutory language. The more logical presumption—particularly at the time that Congress enacted the NGPA—is that a deregulated price "could" be higher than a price subject to regulatory controls.

The court of appeals further held that the term "could" in section 101(b)(5) must be interpreted by examining the prices to be paid in each actual sales transaction. (App. 16a). This approach contravenes the statute's price deregulation timetable and its mandate that contracts determine natural gas prices. As the FERC recognized, "whether the *contract* allows the producer to collect a price higher than a regulated price is a contractual issue, not an issue raised by the deregulation scheme of the NGPA." (App. 111a) (emphasis in original). An actual comparison of applicable prices at each moment to determine the regulatory status of sales of dually-qualified gas is clearly outside the deregulated, market-based pricing scheme envisioned by Congress.

Additionally, the court of appeals maintained that by focusing on the NGPA's price deregulation provisions,

³ 15 U.S.C. § 3311(b)(5) (1982) (emphasis added). (Hereinafter cited as NGPA Section 101(b)(5)).

the FERC improperly overlooked congressionally-mandated incentives aimed at increasing gas supplies. (App. 22a). The court of appeals failed to appreciate, however, that the prospect of price deregulation was also an incentive to the exploration and development of additional gas reserves by producers. (See App. 74a n.10). Moreover, price deregulation was intended to eliminate the need for continued incentives because the market would provide sufficient incentives to balance supply and demand.

Under the court of appeals' reading of NGPA section 101(b)(5), Congress' ultimate goal of achieving an increasingly decontrolled market for natural gas would be frustrated because deregulation would never fully occur with respect to dually-qualified gas. At any time, producers could elect price control over decontrol, depending upon which option suited them best. Thus, in times of excess supply, producers would be shielded from the lower prices dictated by the market. On the other hand, producers could take advantage of higher prices caused by a shortage in supply. The court of appeals' decision is therefore contrary to the congressional effort to allow market forces to determine prices and "to eliminate the distortive effects that NGA price control had had on supply and demand." *Transcontinental Gas Pipe Line Corp.*, 474 U.S. at 424, n.6.

II. THE COURT OF APPEALS' DECISION WILL HAVE A SUBSTANTIAL UNWARRANTED ADVERSE IMPACT ON NATURAL GAS PIPELINES AND THEIR CUSTOMERS

Respondent CNG Transmission, a natural gas pipeline serving distributors in New York, Ohio, Pennsylvania, and West Virginia, purchases natural gas that is qualified for both a regulated and a deregulated price category. Under the court of appeals' decision, prices for dually-qualified gas will be held at artificially high levels. Producers will presumably elect price regulated cate-

gories because regulated prices are higher than the current prices available under contract provisions applicable in the event of deregulation. CNG Transmission estimates that, as the result of these producer elections, the cost of gas that CNG Transmission purchases will increase substantially, notwithstanding the current surplus of natural gas supply deliverability.

Additionally, many existing gas purchase contracts between CNG Transmission and producers provide for price renegotiation if deregulation occurs. Under the decision of the court of appeals, gas reserves subject to these contracts may never be in a deregulated category because deregulated status depends on a renegotiated price that is higher than the regulated price. Since the prerequisite for a renegotiated price is deregulation itself, such price renegotiation will not occur. Although the court of appeals recognized this anomalous situation, it dismissed the problem in a footnote, as if it would have little overall impact. (App. 16a-17a, n.11). A contrary conclusion is true for CNG Transmission which purchases significant amounts of gas under contracts with provisions that lead to this "Catch-22." The problem affects 60 percent of CNG Transmission's producer gas eligible for deregulation. Although CNG Transmission's contracts anticipate deregulation, this gas will remain subject to regulatory controls and, consequently, to artificially higher prices.

The FERC estimates that the nationwide, 1985-1987 cost of the court of appeals' decision in higher natural gas prices is approximately \$300 million. The effects will be further reaching, however, because many gas purchase contracts contain take-or-pay provisions. To the extent that gas is rendered unmarketable by the artificially higher prices, it could be shut-in. Thus, higher prices will aggravate both the current surplus and the enormous take-or-pay burden faced by pipelines. See *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1023 (D.C. Cir. 1987).

The higher annual gas costs flowing from the court of appeals' decision will be passed on to ultimate consumers by virtue of NGPA section 601(c)(2), 15 U.S.C. 3431 (c)(2) (1982), which provides for guaranteed pass-through of NGPA-determined prices, absent fraud, abuse, or similar grounds. Thus, if the court of appeals' decision is allowed to stand, the congressional aim of providing customers with adequate supplies of gas at reasonable prices will be frustrated.

CONCLUSION

The court of appeals' interpretation of NGPA section 101(b)(5) is inconsistent with Congress' long-term goals in enacting the NGPA. The judgment of the court of appeals should be reversed.

Respectfully submitted,

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January 14, 1988

ADDENDUM REQUIRED BY RULE 28

Respondent CNG Transmission Corporation is a wholly-owned subsidiary of Consolidated Natural Gas Company. Other subsidiaries of Consolidated Natural Gas Company are:

CNG Coal Company;
CNG Development Company;
CNG Energy Company;
CNG Producing Company;
CNG Research Company;
CNG Trading Company;
Consolidated Natural Gas Service Company, Inc.;
Consolidated System LNG Company;
Hope Gas, Inc.;
The East Ohio Gas Company;
The Peoples Natural Gas Company;
The River Gas Company;
West Ohio Gas Company.